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SUBJECT: AMBASSADOR'S VISIT TO MORAVIAN-SILESIAN REGION:
REGIONAL POLITICS AGAINST THE CENTER, PLUS STEEL, TRUCKS,
AND IRAQ PROCUREMENT

1. Summary. During his February 7-8 visit to Ostrava, regional governor Evzen Tosenovsky told the Ambassador the influence of the regions is growing, and that an accommodation between Prague and the regions must be worked out within his ODS party. The Ambassador visited Vitkovice Steel, which the GOCR is in the process of selling. Vitkovice has significantly downsized over the past few years and is enjoying a good year in favorable world market conditions, but suffers from a dependency on one source of raw steel controlled by a competitor. The government hopes to realize around \$200 million from its sale. A visit to Terex Tatra trucks revealed another company that has shed employment, a move that has caused hard feelings against its American management. Tatra directors were concerned about purchasing procedures used by the U.S. Army to supply troops in Iraq. End Summary.

EVZEN TOSENOVSKY, REGIONAL AND ODS LEADER

2. During his February 7-8 visit to Ostrava, the capital of the Moravian-Silesian region, the Ambassador met with its governor, Evzen Tosenovsky. Tosenovsky is both a leader of the opposition ODS party and a leader among the regional governors, twelve out of thirteen of whom are ODS members. Tosenovsky governs in Ostrava with a center-right coalition of the ODS and the Christian Democrats (KDU-CSL). The region is hard hit by the drastic downsizing of its traditional coal and steel industries, but is actively promoting new investment from abroad. Tosenovsky was pleased that the region has already attracted some quality companies such as Siemens and Visteon. He is eager to develop the Mosnov airport to give executives -- especially Americans -- direct links to international flights from Vienna. Tosenovsky was optimistic about the Czech Republic's future success in trade with Vietnam. He mentioned that "half of the Vietnamese government speaks good Czech", having studied in Czech schools. His region has an agreement with the Vietnamese Chen Hua province for cooperation. He views prospects for trade with China and India as promising.

VITKOVICE STEEL PRIVATIZATION

3. The Ambassador inquired about the status of the privatization of Vitkovice Steel, the third-largest steel mill in the region after Nova Hut and Trinec Ironworks. Tosenovsky said that the success of Vitkovice is vital to the further development of Ostrava and the region. He said that there is strong interest from Russia in Vitkovice and from Mittal Steel, the owner of Ostrava's Nova Hut and VPO, a pig iron producer that supplies not only Nova Hut but also Vitkovice. Tosenovsky thought that coordination of the Czech mills with very similar mills in Poland is important, and he said both Mittal and the Russians work well with Polish mills. Tosenovsky guessed that the government is not in a hurry to complete the privatization because the political situation is very complicated. He said that a new owner is not likely to lay off more employees, as the company has been stabilized and world demand for steel has revived. He considers the time right for the government to sell Vitkovice.

4. Since its privatization to Mittal, Tosenovsky said, Nova Hut has become something of a black box. It has been clever in reducing excess employment, offering attractive severance packages to employees willing to leave. Its economic results seem to be good, given the current strong market conditions. But because of uncertainties at Nova Hut, Tosenovsky is hopeful that a strong new owner for Vitkovice will be found.

5. Later in the day, the Ambassador met with management of Vitkovice steel and toured its production facilities. Vitkovice had one of its best years ever in 2004, benefiting from worldwide shortages of steel and concomitant higher prices. It has undergone significant restructuring in the past five years, dropping from 12,000 to 1500 employees since 2000. The layoffs are one of the reasons the Ostrava area suffers from 20% unemployment.

6. Vladimir Baar, CEO of Vitkovice, said that he expects the

sale of Vitkovice to generate from 4.5 to 5 billion crowns (\$195-217 million) for the government. However, he said that the American firm Nucor has dropped out of the running to purchase Vitkovice. Other reports indicate that the Russian firm Severstal is no longer interested either. Both firms were probably put off by Vitkovice's key vulnerability: it is dependent for all its supplies of raw steel on Vysoka pece Ostrava (VPO), which along with Nova Hut is owned by Mittal. Vitkovice is already litigating with Mittal over what Vitkovice views as unjustified price increases. Mittal is still actively pursuing the purchase of Vitkovice, even though the Czech government has said that it must settle the lawsuit as a condition for putting in a bid. Settlement discussions are well under way and the government has an interest in having Mittal in the game to bid up the price. Trinec Ironworks and the Czech investment firm Penta are also said to be interested in Vitkovice. So are Arcelor of Luxembourg and Donetsk Steel of Ukraine, among several others. According to Baar, offers are due in mid-March and the government would like to make a decision on the buyer in June.

THE REGIONS AND PRAGUE IN POLITICS

17. Tosenovsky was proud that the message of his ODS party on terrorism and in support of Czech participation in the mission in Iraq was strong. The November regional and Senate elections were clear successes for the ODS, he said, helped along by CSSD mistakes. Now, of the 13 regional governors, 12 are ODS, and their attitudes toward the U.S. are friendly. Tosenovsky said that the U.S. elections last year were important to the world and that they "turned out well". Because of the ODS's strong regional representation, it makes the situation complicated for the parties' national leadership, Tosenovsky said. Regional-national cooperation is essential, but ODS does not have a clear formula for doing so. The national leadership in the person of ODS Chairman Miroslav Topolánek (who stands to be Prime Minister after the 2006 election) should use, and not fear, regional political power, which will only become more significant in the future.

18. Tosenovsky believes that with regional support, the ODS is sure to be a winner in the next parliamentary elections. More generally, he sees a need for decentralization, since Prague is a very different world from the rest of the country. Lobbying occurs only in Prague, he observed, which is dangerous for the Czech Republic's political and economic future. He sees tensions rising between the regions and the center. There are separate rules for Prague and for the regions, which in his view is bad. President Klaus, he remarked, does not like the regions as they are now constituted, and his views carry weight in the ODS. The dramatic reforms of the post-1989 period may have required strong central control, but times are changing, he said.

19. Note: The regional governors have founded an association and held their first meeting the week following the Ambassador's visit to Ostrava. Tosenovsky chairs the association and told us after the two-day meeting that the governors discussed organizational issues at first. They then moved on to a discussion of how to stabilize the forested areas of the Czech Republic. Large parts of these areas are owned by the state and are faced with pressure for privatization. The governors' would consider transfer of such areas to the regions favorably. Water management was another issue. The governors fear that strict EU regulations for water management cannot be met because compliance is too expensive. One outcome of this discussion was a proposal for a joint meeting of all thirteen regional governors with the Ambassador in Prague.

TATRA TRUCKS RESTRUCTURES, FINDS SELLING TO THE U.S. ARMY DIFFICULT

10. On February 8, the Ambassador toured the 2200-employee Terex Tatra truck manufacturing plant in Kopřivnice. Tatra trucks have a long history and have a deserved reputation for ruggedness. Since 2003 Tatra has been under the control of the United States firm Terex. Tatra has a traditional customer base in Russia, China and the Middle East. It has won contracts to supply trucks to the Israeli army, and is in line to supply the Czech Army and the Iraqi government. While in Kopřivnice, the Ambassador saw a prototype truck that Tatra is preparing to compete for a U.S. Marine Corps tender. The company is strongly vertically integrated, but is trying to move more of its parts production to independent suppliers. Efforts to streamline the company have caused some hard feelings in Kopřivnice, where Tatra is the dominant employer. These complaints have attracted the attention of President Klaus, who recently visited Tatra to get a feel for what is going on there. However, the company is operating in the black, and it is hopeful that some management changes may help to sooth local sensitivities and boost morale among employees.

11. In his discussions with Tatra management, the Ambassador heard serious concerns about how the U.S. Army's purchasing process for Iraq service is working. In particular, the management took issue with the Army's practice of lumping together totally unrelated items in a single tender. This results in bids from middlemen who gather together sub-contracts from numerous suppliers. The management contends that narrower tenders, even if somewhat more expensive to administer, would result in lower-cost, more professional bids direct from manufacturers. The management was also critical of the way specifications for truck purchases are developed, saying that they clearly are not developed by people who understand how trucks are made. The result, they say, has been bids that are low, but do not result in quality products on the ground.

12. The Ambassador and Mrs. Cabaniss addressed two separate classrooms of secondary school students at the Koprivnice Secondary Technical School and College about various aspects of American life and their impressions of the Czech Republic. They met with the rector of Ostrava University. Mrs. Cabaniss visited a model community where Roma and non-Roma live together, and where Roma can obtain job-seeking and other social support.

CABANISS